

March 1, 1978

LETTER 723

Feb. 17, DJIA 752.69; PTI 702; A-D Ratio -22.21

Feb. 24, DJIA 756.24; PTI 700; A-D Ratio -21.98

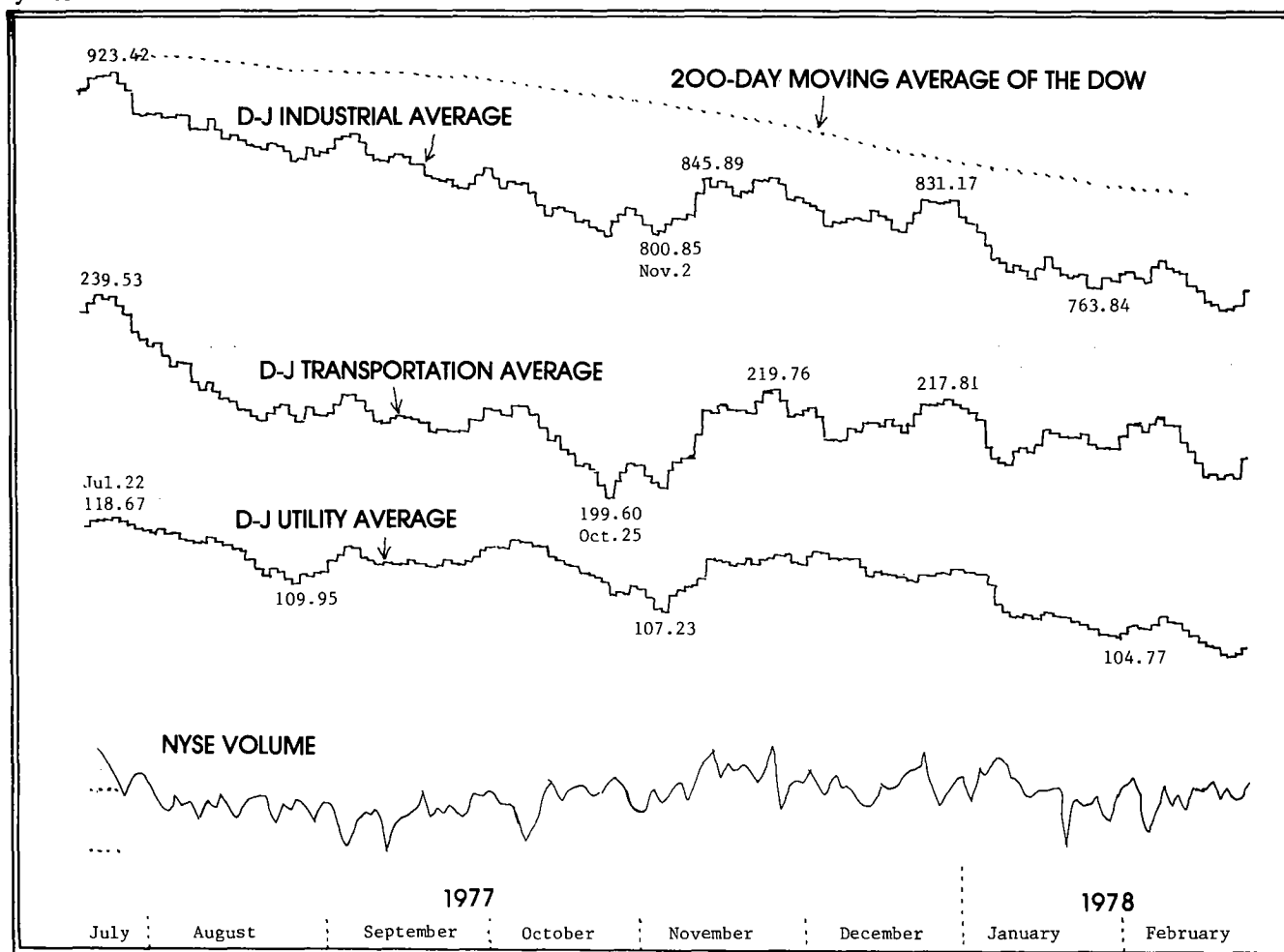
THE MARKET: Writing a stock market report is not the easiest task in the world. Over the years I've seen a lot of letter-writers come and go, and I've seen lots of white knuckles and gobbled libriums and sleepless nights. I also note that as the pressure increases, many of the market advisories become desperate to prove their worth to their subscribers ("read me, I'm a genius"). Thus, these advisories often turn to "predicting" every turn and squiggle on the charts, every Dow rally or decline of 10 or more. Which, of course, is an endeavor that never works, never has worked, and never will work.

In "the good old days" many a NYSE floor trader was in business for himself, and many made good money moving on an in-and-out daily trading basis. But that was during the big bull markets of 1942-46 and 1949-66, when the trend was overwhelmingly up, when the going was easier, and when the rules were more lenient. I don't know how many floor traders trade strictly for their own account today. But my bet is—very, very few. And if they (the floor traders) can't do it with benefit of no commissions and the smell of the tape in their nostrils, who are you and I to "beat the market" on the daily pops and crackles. The fact is that it can't be done. Nevertheless, a lot of neophytes have to go through the patched-pants route to find out what you and I already know.

The great market movements, whether primary or secondary, the really profitable movements, don't depend on split-second timing. They don't depend on our leaping into the market on a Monday—because by Tuesday all will be lost. The really profitable movements usually give you time to take initial positions, they give you time to add to positions, and they tend to "tell you that you're right" as they gather upside steam.

Therefore, I may be a bit conservative with my advice, but before I shout, "This is it, this is the place where we buy 'em" I ask myself, "Russell, take it easy, hold it, is this the place where you (meaning me) would buy stocks? Is this a spot where things look right, where the puzzle fits together. Have we arrived at the spot where you're going to take your own hard-earned money out of hibernation and swap it for stock certificates?"

Anyway, those are some of the things that go through my mind as I write these reports. There's always plenty of pressure to give people what they want to hear. But I operate on the thesis that the only way I'm going to serve my subscribers is to tell them the truth as I see it. That's all I offer, and I realize that it isn't always "a rose garden" and it isn't always "a child's garden of verses."



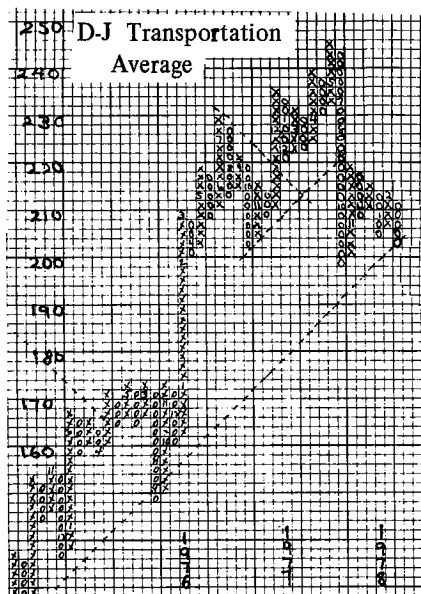
Ever since 1978 started I get this feeling that the market on one hand, and gold on the other, are acting out some kind of strange stage performance. Here's gold, inching up, backing off a bit, pushing to new highs, climbing steadily, while nobody seems to believe it—or if they do, they don't give a damn. Except for my own subscribers (most of whom have purchased gold), I don't read much that is bullish about the metal. Even the former gold-bugs talk about gold "hitting a high of maybe 185 or 190 before it tops out." Maybe so, but the further gold climbs without stirring up any excitement, the higher I put the ultimate top.

As to the market, the exact opposite set of circumstances appears to be the case. Day after day the market stumbles or sags. Yet the odd-lotters have pulled in their bearishness, odd lot shorts are almost non-existent, speculation continues, centered on the latest "take-over candidates," and analysts vie with each other in telling their readers "how cheap stocks are." Ultimately, the downside is going to get emotional, but the further down the Dow and the various indices go without that excitement, the lower I put the ultimate bottom of this move.

As noted in recent Letters, there are two plusses in the current technical picture. The first is that the Transportation Average has not yet violated its October 25 low of 199.60. The second is that the advance-decline ratio has not yet broken below its October low. Both of these phenomena represent non-confirmations in that the two indicators (Transports and the A-D ratio) have not confirmed the succession of new lows in the Dow.

Nevertheless, I do not take any great comfort from the situation at this time. On February 21 the A-D ratio broke to a 1978 low, halting just 17/100th's from its October low. Thus, we had a "miss" yet somehow I don't think the A-D is going to resist its late-1977 low for long.

By the same token, the D-J Transportation Average halted its decline about 3 points short of its October low of 199.60. But here again I am not too hopeful that this non-confirmation will



persist. I am including this P&F chart of the Dow Transports covering the period of 1975 to the present. What we see here is a perfectly massive "head-and-shoulders top" with a price of

200 rupturing the major (primary) trendline and a price of 198 smashing the whole structure. Of course, under strict Dow Theory any closing price of 199.59 or less will signal a downside confirmation by Transports.

With the coal strike still not settled, many are blaming that situation for Transport weakness. But the market knows that every strike in history is eventually settled, and I believe the settlement is *already discounted* by the Transports. Thus, the Transports may hold up while the strike persists, but I would expect them to "fall apart" once the strike is actually settled.

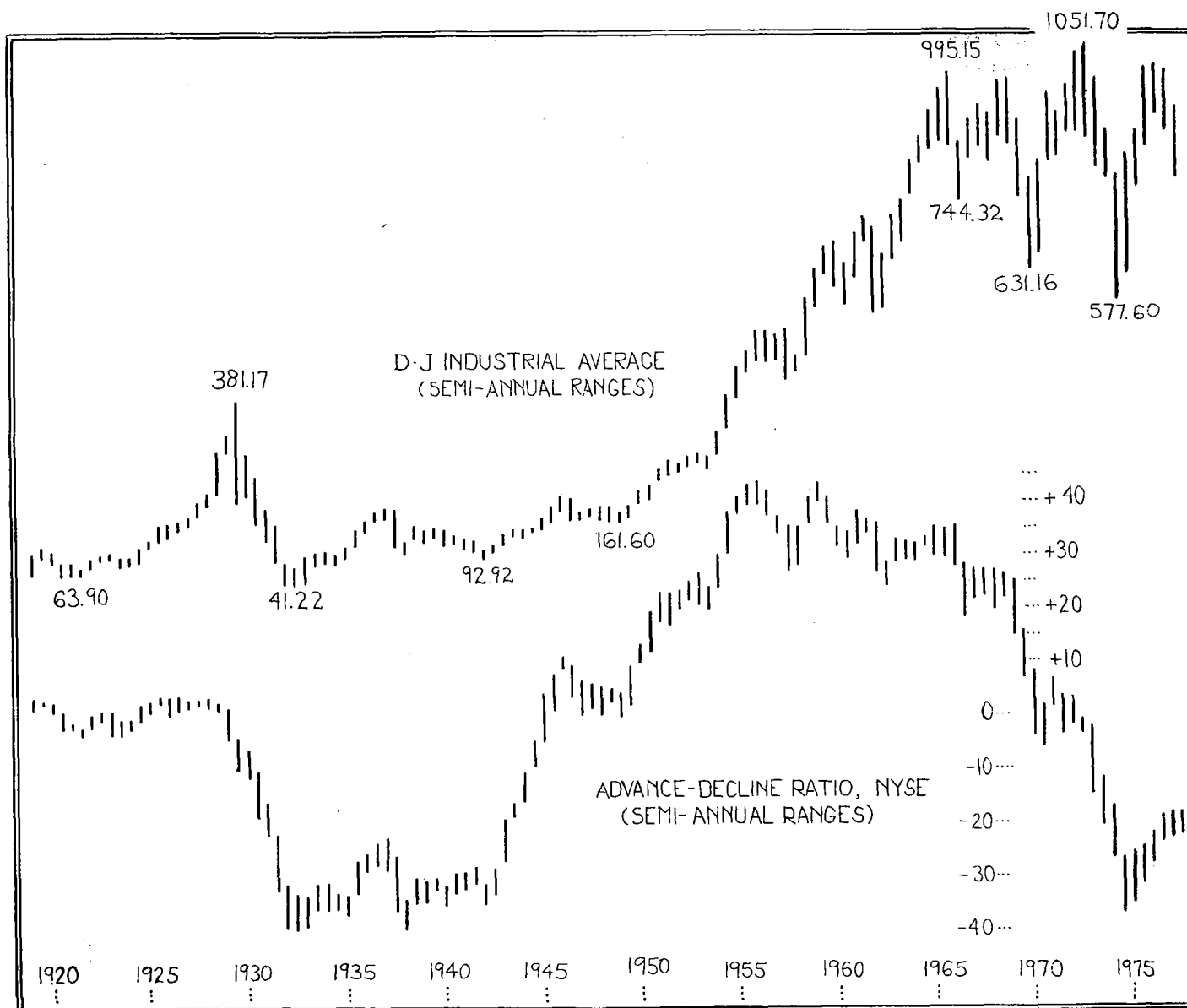
As this is written, my over-bought and over-sold market indicators are again registering a SEMI over-sold, but not a thoroughly over-sold condition. This same situation has occurred many times during the last 12 months, and each time the market rallies feebly, then turns down and goes to new lows. Thus, if a rally develops in this area I am going to say what I have been saying about every rally since last May—"Skip it."

COMMENT: Veteran Wall Streeters know that **news goes with the trend**. For instance, during the 1950's when a snorting bull market was in force, inflation was accepted as a bullish factor for the market. Stocks were touted as perfect inflation hedges (as indeed they turned out to be—right up to the bull market highs in 1966.) But now, with the primary trend down, every hint of more inflation draws glowers from Wall Street, and the stock market obediently sags under fresh inflationary strains.

Another variation of the old adage is that during a bull market all news favors the upside, but during a bear market every piece of news seems to favor the bears. Perhaps this explains the "Jimmy Carter experience," or it could be that my imagination is simply playing tricks on me. At any rate, I have this feeling that everything that Carter touches turns to er, ah,—mud. Carter wants a Panama treaty, and it turns out that the President of Panama has a family that deals in dope. Carter brings in his buddy Bert Lance, and Lance turns out to be a "baddie." Carter talks about an energy crisis, and the world serves up an energy glut. Carter promises to balance the budget, and he runs up some of the biggest deficits in US history. Carter promises to cut down Federal red tape, and he creates a new Energy Department that promises to be a monster. And on and on and on. Only one question runs through my mind, how in the devil did Jimmy Carter ever make a living in the peanut business?

PERSPECTIVE: I am including my chart (page 3) of the D-J Industrial Average and the Advance-Decline Ratio. This chart shows the range for each six month period. In other words, there are two bars plotted for each year (each bar connects the highest and lowest daily points for each respective six month period).

I don't think most investors (or analysts for that matter) realize what has occurred in the A-D ratio on a long-term basis. First, it is interesting to note that a most flagrant early case of breadth-price *divergence* occurred during the period of 1926 to '29. At that time the A-D ratio (breadth) flattened out while the Dow spiked up to its famous September 3, 1929 closing of 381.17. The aftermath of that extraordinary divergence between the Dow and the majority of stocks (as measured by the A-D ratio) was the worst bear market in Wall Street annals.



In many ways the 1932 to '42 period can be termed a basing period for the market. You can see this in the extended sideways movements in both the Dow and the A-D ratio (actually, of course, the profitable 1932-37 bull market was sandwiched in during the base period, but later prices slid back to the base area again.

In 1942 the Dow and the general market turned up, and the first post-depression bull market was on. Between 1942 and 1946 almost every stock on the NYSE headed substantially higher. This was followed by the mini-bear market of 1946 to 1949. In retrospect, we can see that the 1946-49 period constituted another basing area for the Dow and the A-D ratio.

A major bull market started in June, 1949, and again the Dow and the A-D headed higher. By early-1956, the A-D ratio (following its 14-year rise) topped out. From there, a most curious and extended period of divergence occurred. The action following 1956 took on the following characteristics: the Dow would advance to a new bull market high, but the A-D ratio would fail to better its preceding peak. A new downward swing would result (each down-swing successively more violent than the preceding). Then a new advance would begin from the shambles of the previous price-breadth collapse.

During the 1969-70 decline the A-D ratio (see chart) exhibited a weakness which far surpassed anything seen in decades. During the two years of 1969 to 1970 the A-D ratio lost a whopping 30 points, a true breadth disaster. Yet, the subsequent recovery took the Dow to a new all-time high of 1051.70 in January, 1973.

In the face of this extraordinary and divergent action, the market again turned down and during the period of 1973-74 the A-D ratio lost approximately 35 points, the worst two-year period for breadth in history.

Next comes the mini-bull market of 1974 to 1977 (1974 to '76 if we are referring to the Dow alone). This bull market produced six successive semi-annual periods of rising breadth, the most persistent A-D action since the 1956 high. Furthermore, the 1974-77 advance added almost 20 points to the A-D ratio, and it therefore qualifies as the best breadth rise (in extent) since 1956.

To bring the study to the present, much is written about the current "great rise and holding action" in the secondary and "non-Dow" stocks. But it may be well to realize that from the breadth standpoint, the rise of 1974-77 failed to make up even half the loss from the 1970 bottom. Thus, the average stock, as

measured by the A-D ratio, recovered only a fraction of the losses sustained during the breadth crash of 1966 to 1974 (see chart).

It is my opinion that a primary bear market started for the Dow on September 21, 1976, and a primary bear market began for the A-D ratio at its July 22, 1977 high. From here on, it's a matter of how the bear market expresses itself and how the technical situation unwinds. One of the indices that I will be paying particular attention to is the A-D Ratio, as seen on this chart. But it is the long-term A-D chart, I believe, which will provide us with a vital perspective on the bear market and the technical picture over coming months.

ELLIOTT: I have been doing a great deal of thinking regarding (1) the massive debt picture in this country, (2) the action of the market, (3) the very long term picture, and (4) all of this in terms of the Elliott Wave Principle. Mr. George E. Barber (PO Box 5271, San Jose, CA 95150) is an investment advisor who does extensive work with Elliott and moving averages, and his view of the market and Elliott is different from most that I have seen. I've studied Barber's work at length, and I believe his interpretation could be absolutely valid.

One particular facet of this analysis interested me, and that is the conclusion that a great bull market ended in 1966. This has always been my contention; it was also the opinion of the late, great, E. George Schaefer (whom I corresponded with during the 1960's and 1970's). Barber believes that the entire rise from 1932 to 1966 was simply final leg V of a massive grand super-cycle. Barber also believes in an approximate 54-year cycle, which implies that the final bottom of the bear market which began in 1966 will occur around 1986 (or 54 years from 1932, the bottom of the great 1929-32 bear market).

I have included this chart which shows Barber's concept of the Dow from 1932 to the 1966 bull market top, and then the bear market to the present. But it is the picture which lies ahead that I believe (if this interpretation is correct) will be of vital interest to subscribers. The bull market from 1932 took the Dow up in five Elliott waves (A,B,C,D,E) to the **1966 top** of 995.15 on the Dow. From there a great bear market began. The bear market will assume the form of three major legs down. The three legs will cover around 20 years in time (1966 to 1986) and they will take equities to lows perhaps not seen since the 1940's or 1930's.

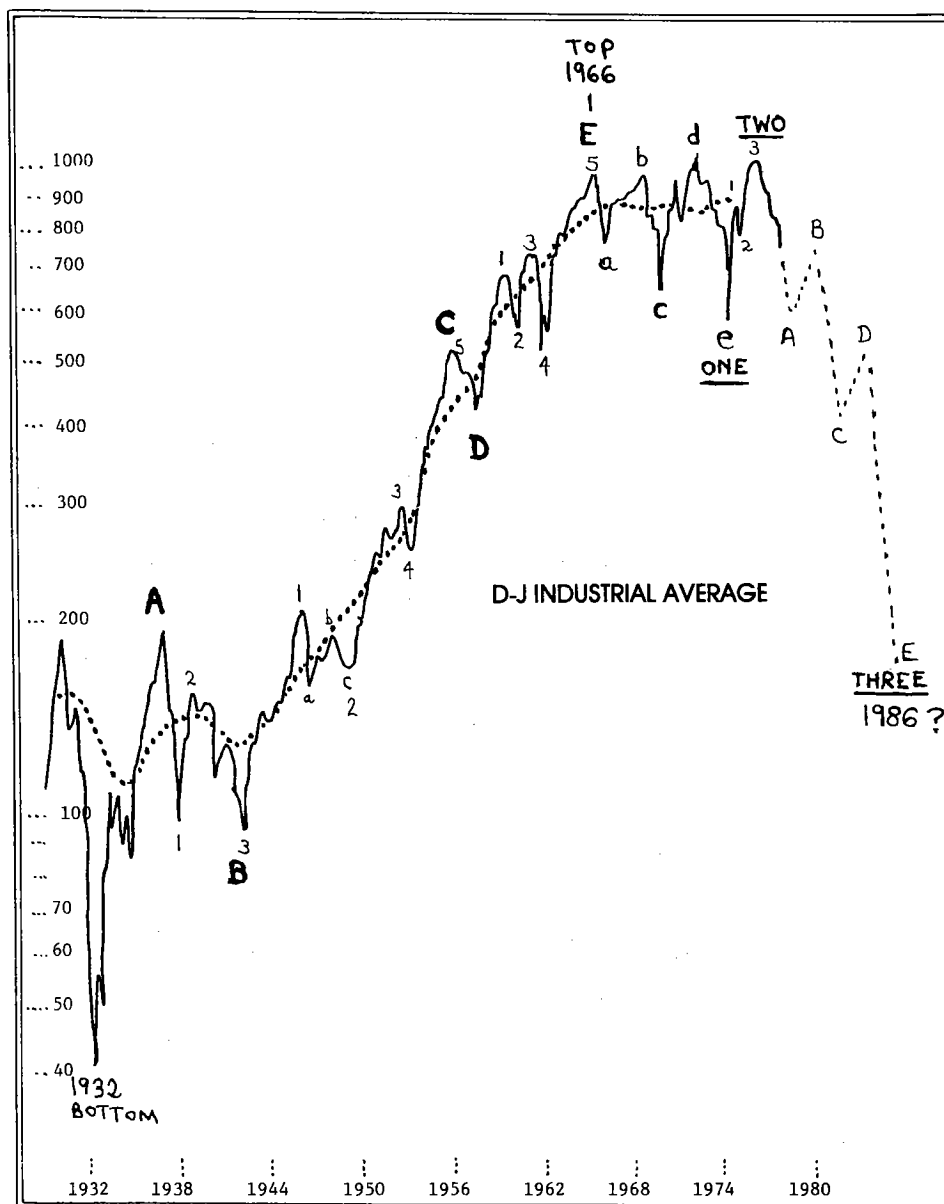
The first bear market down-leg took the form of an a-b-c-d-e wave down to the 1974 low of 577.60 on the Dow. This ended

at **ONE** on the chart. The recovery wave (which we refer to as the bull market of 1974-76) ended for the Dow on September 21, 1976 at 1014.79. This wave is labeled **TWO** on the chart. Currently, we are well into down-leg A, the first leg of an A-B-C-D-E series of legs down, all of which comprise final major wave **THREE** as shown on the chart.

A number of further observations should be made here. (1) The dotted line on the chart is an 80-month moving average which is centered (it is charted between the 40th and 41st month). This provides a very long term picture of the Average Dow price, and as you can see this moving average is in the process of "rolling over" and heading down. The bearish implications of such a move are clear enough.

(2) Even though this Elliott view of the picture ahead is ominously bearish, note that there will be advances (leg B and leg D), and these advances could be powerful enough to be labeled mini-bull markets. Thus, even though a major super-cycle bear market is now in effect, it will be punctuated by two mini-bull markets, each of which could be highly profitable.

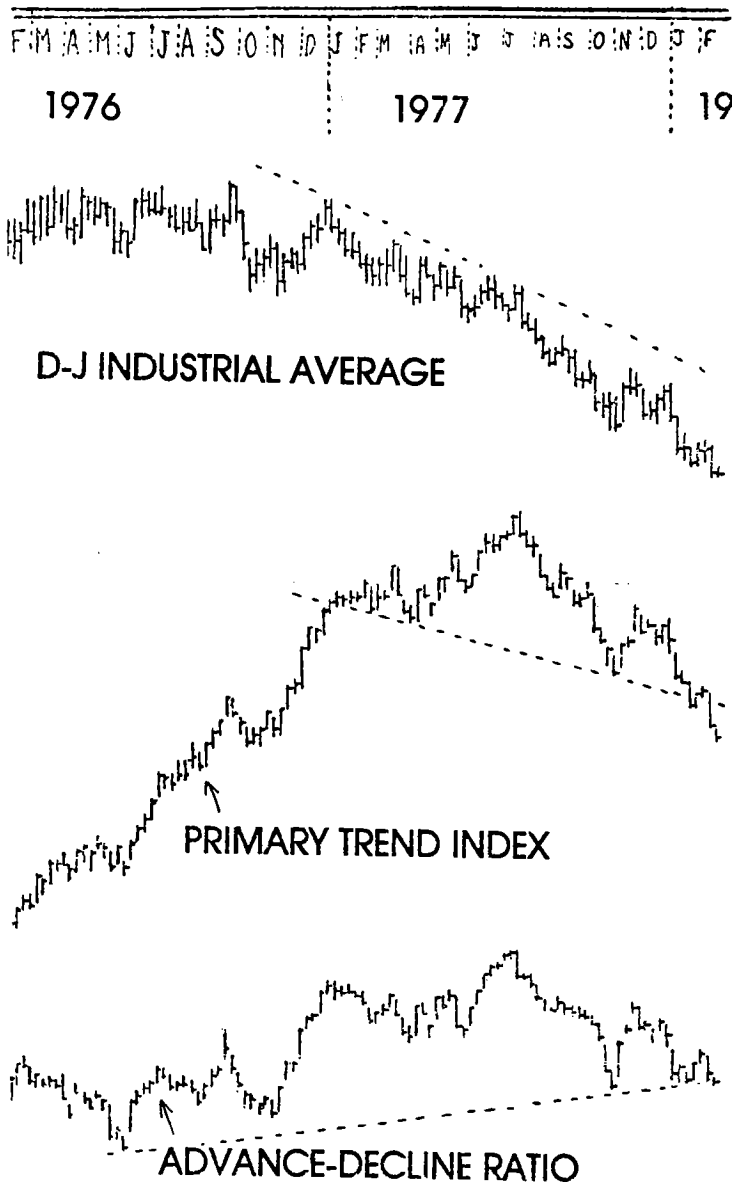
(3) The question immediately arises, when does the current down-leg A end, and when does leg B (which could be a very profitable rise) start? The only intelligent comment I can offer here is that current down-leg A will end when this market stirs up enough FEAR to produce a major over-sold condition. That could occur during this spring or summer, but as I have said so many times before, it is far easier to **identify** such areas than it is to predict them.



(4) Although the Elliott scenario presented here is a most discouraging one for the long-term, it fits into my presentation in the last Letter regarding "survival." It also fits into the section (last Letter) which deals with the necessity for investments which are very liquid (marketable) and the extreme need for proper timing over the period ahead.

(5) Finally, this Elliott scenario fits into my overall picture of a tremendous **liquidation of debt** in the period ahead. And that is what I think the whole bear market is going to be about—the liquidation of the unbelievable mountain of debt (in all sectors of the economy) that has been building up since 1932—but much more importantly since World War II.

Speaking of liquidation, the latest (January) statistics show what could be a straw in the wind. January saw the first drop in NYSE margin debt from the \$9.7 billion record high, a drop to \$9.6 billion. During bear markets it is normal for the margin debt to be steadily liquidated. It therefore would not surprise me to see margin debt drop to 15% to 25% of its record high before this bear market breathes its last. Despite the drop in margin debt, however, I note that the number of margin accounts actually increased by 5000 in January.



PTI, A-D RATIO, DOW COMMENTS: I show here my weekly chart of the Dow, the Primary Trend Index (PTI) and the A-D Ratio for the NYSE. Note that my PTI, which is an amalgam of eight different averages and indices, has formed a huge head-and-shoulders top, and has cracked decisively below its support line (dotted line). This is telling me that the technical "understructure" of this market is now shattered, and that the overall sweep of the various technical indices should now be heading down (with intermittent rallies, of course).

Next, note the continuing *divergence* between the Dow and the A-D ratio, as defined by the dotted trendlines. On February 22 the A-D declined to within the barest fraction of its October low, but the next two days brought in a news-inspired rally. Thus the A-D continues its cliff-hanging act. With the PTI looking this ominous, however, I would not expect too much out of this market on the upside.

NOTICES: We have sold out all of the Advance-Decline Ratio chart albums, and that will be it. I'm not going to print any more, but, of course, I will continue to offer updated pages covering each new year's action. I do have a small number of the D-J Averages album, and when these are gone I will not reprint them. The albums are loose-leaf, hard cover, and each page is 11" X 15". These are the only chart books available covering the daily action of the four D-J Averages together with volume (included are the D-J Industrials, Transports, Utilities, Bonds) going back to 1885. The price for the album is \$49, and \$52 if you live in California (this item is tax deductible). As I've said before, I originally put this album together because I personally needed the information and couldn't find it anywhere. I believe it represents a rare and useful item for every businessman, investor or trader. I will offer an updated page each year.

NEXT NOTICE: In the last Letter I said our new baby was scheduled for around March 5. I don't know whether young Ryan respects schedules, charts and predictions, but judging from my wife, Paula's, tummy, it won't be a heck of a lot longer. Therefore, I am going to take two weeks between Letters, and the next Letter is scheduled to be mailed on March 15. If something unforeseen, fabulous, catastrophic or irresistible occurs in the interim, I will rush out a special letter. If the world and the market progress in normal fashion, expect the next Letter on March 15.

LONG TERM? A Florida subscriber called and told me that he was disgusted with being in business, had sold his corporations, and was now "liquid." He wanted to know what I see "over the long term." I told him that there is no long term any more. In 1910 or 1930 a man could sell his stocks or his house or his business, put the money into bonds or in the bank and know what he had. You can't do that anymore, because nobody knows what a dollar is. Look at this listing, and you'll see what I'm talking about.

PRESIDENT	DATES	\$1 AT TERM END
Truman	1/49-1/53	90.2 cents
Eisenhower	1/53-1/61	80.7
Kennedy-Johnson	1/61-1/65	77.0
Johnson	1/65-1/69	67.6
Nixon	1/69-8/74	48.0
Ford	8/64-1/77	41.0
Carter	1/77-1/78	38.9

So today, we move one step at a time. Right now it is T-bills and gold, with the next step probably being an entrance into the stock market at the important bottom that I see somewhere ahead. But as for long-term planning, sadly I have to say, "Forget it."

I hesitate to even include the Elliott study in this Letter; I hesitate because the study is so bearish. But I believe the study is valid, and I don't sell my wishes, I sell my thinking and my work. So if you have to have a long term, maybe this Letter provides some kind of an answer.

GOLD: As long as I have discussed the market in terms of Elliott, I may as well go the whole hog and up-date gold in terms of my Elliott studies. As older readers know, Elliott views all bull markets as unfolding in a series of five rising waves (three up-waves and two intervening downward waves). Elliott bear markets take the form of two down-waves with an intervening rising wave. Of course, this is a very simple explanation, since each of the waves divides and sub-divides.

At any rate, I include a long term arithmetic chart of Gold (1972 to present) showing the A-B-C-D-E bull market which took gold from \$35 to a peak of 180 in early 1974. From here, we witnessed a corrective bear market (1-2-3 on chart) but we had a higher "unorthodox top" of 197.50 at point 2. Such tops are fairly rare, but they can materialize under the influence of heated speculation, a phenomenon which certainly appeared during 1974.

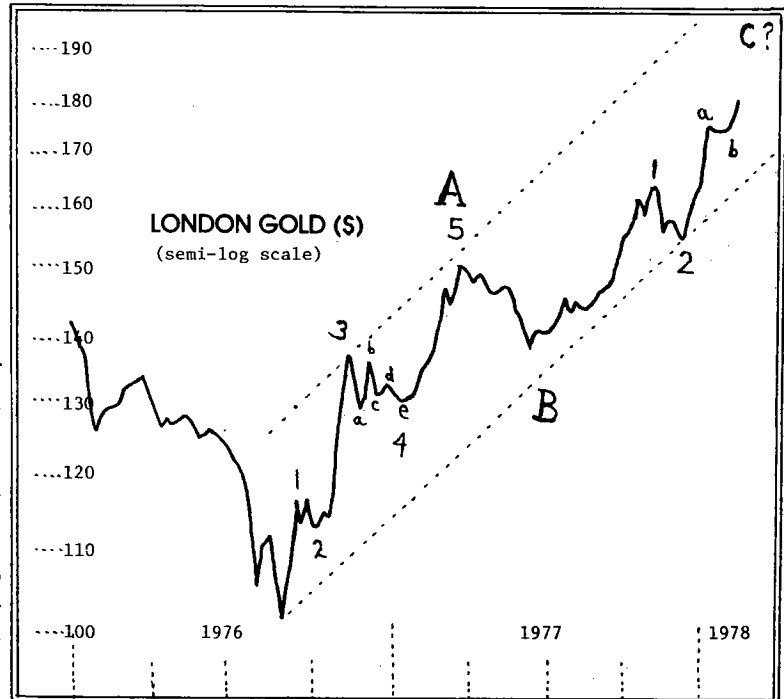
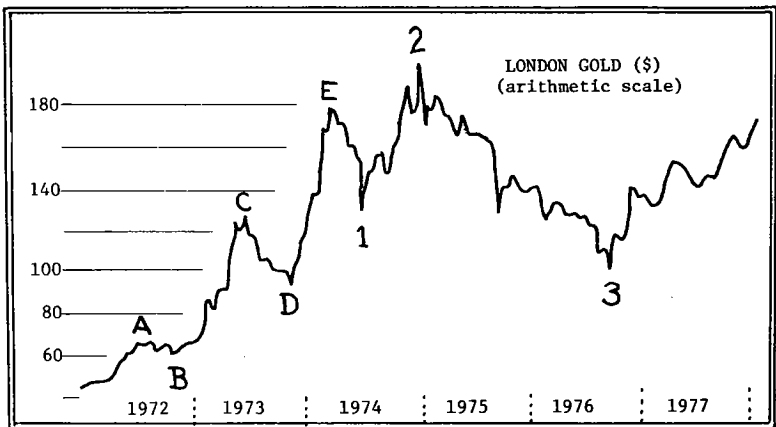
By August, 1976 the bear market had slashed the price of gold to 103.50. From that level a new bull market in gold was born. I have constructed a second gold chart to semi-logarithmic (ratio) scale, and this scale is absolutely necessary if we are to use the device known as channeling. I have drawn a rising trendline connecting the 1976 and 1977 bottoms, with a parallel trendline passing through the late-1976 high. The bull market in gold should develop within this channel.

I see this bull market taking the form of an A-B-C-D-E series of waves. We have already completed Wave A and corrective Wave B, as you can see on the chart. We should now be in rising Wave C, a wave which should break down into five sub-waves. We are currently in sub-wave 3, which follows the correction marked 2 on the chart. Leg A increased the price of gold approximately 48%. If the current rising Wave C was merely to match Wave A gold could rise to the 205 area. My guess is that the current Wave C should be greater than Wave A in terms of percentages, but of course that's only my guess. Following the current Wave C, we should have another correction and then final rising Wave E. This should be the most speculative movement since 1974, but this final rising wave might not appear until 1982 or even later, so at present I'm centered on analyzing Wave C.

Incidentally, this morning I heard that Switzerland was reducing bank interest to foreigners to 1% while barring foreigners from buying Swiss stocks. Thus, the Swiss are cutting off entrance of new dollars, and this should mean more dollars siphoning into gold.

Thought for the week: We're at the point now where if the US Government doesn't inflate fast enough, it's deflationary!

LATE THOUGHTS: By now most of my readers should be familiar with the Fibonacci series of 1,2,3,5,8,13,21,34,etc. In the series each lower number is 61.8% of the following higher number. This is the extraordinary 61.8% Fibonacci ratio.



Applying this to the present, note that the Industrial rise of 1974 to 1976 (577.60 to 1014.79) was 427 points. Now 61.8% of that rise is 270 points, and if we subtract 270 from 1014.79 we get 744. In other words, a 61.8% correction of the 1974-76 Dow bull market would take the Dow down to 744.

The intra-day low for the Dow on this entire decline was reached last week on February 23 at 742.98. This low was within a hair of the Fibonacci target of 744, and it occurred to me that the 743-45 level could set off a Dow rally. If so, the rally would not have an adequate base in that the market was NOT oversold at any time during 1978. My conclusion is that if the market rallies substantially from here, it will soon reach an overbought condition. Such a situation could easily set the stage for a broad new slide.

Conclusion: The Dow 744 Fibonacci level could be significant enough to set off an "impressive rally," but I believe such a rally would represent a TRAP for the bulls. Consequently I do not want my subscribers to move into the market during any rally which may materialize here. Obviously, the recent downside non-confirmations by Transports and the A-D Ratio would provide fuel for the bulls if a rally takes off from here. But overall, the thing to remember is that we buy stocks at the major bottoms, not at potential minor bottoms. And an important bottom should appear before 1978 is over. (By the way, a corollary of the above is that if the Dow does break decisively below 744, I would take such action as quite bearish).

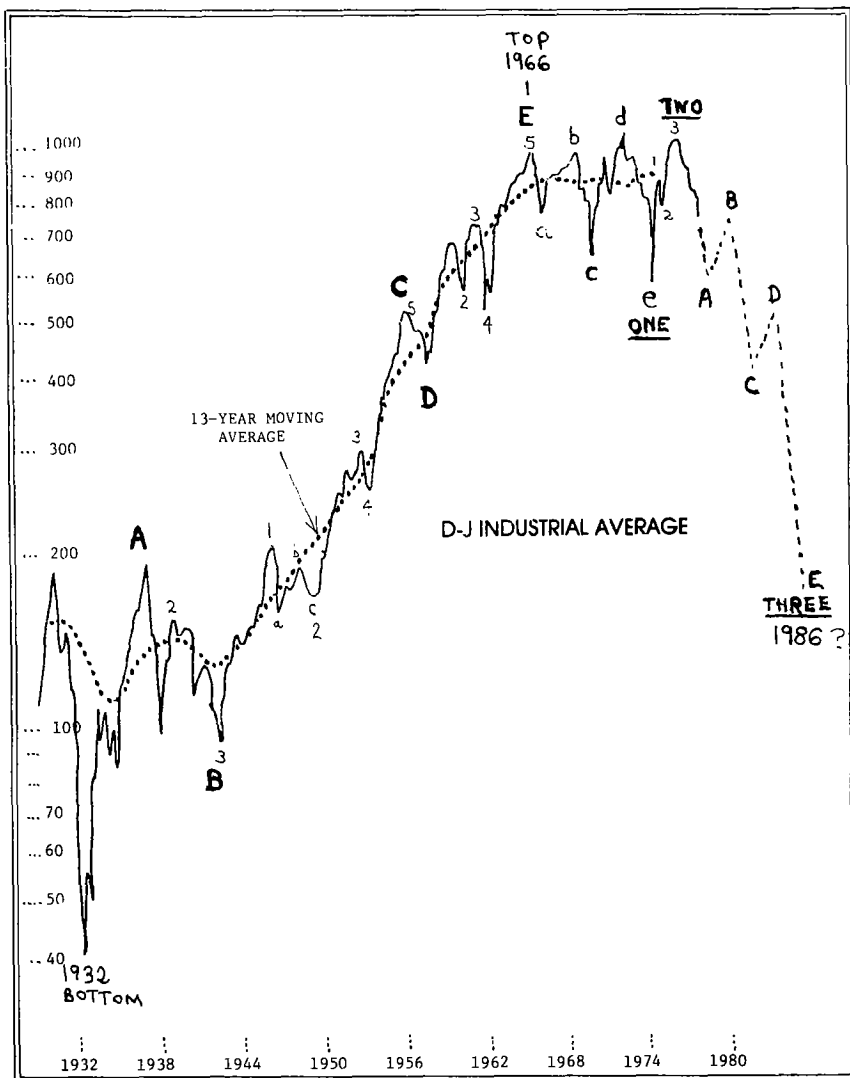
NEXT MAILING: March 15th

**THIS COULD BE THE MOST IMPORTANT
"PICTURE" YOU'LL EVER SEE !!**

What you're looking at here is an Elliott Wave projection for the stock market covering the next 8 years. Obviously, this diagram is only a prediction of things to come, but the prediction is based on logic and knowledge and study. If what you see here comes to pass, then it will be absolutely critical for you to understand fully its meaning for you, your family and your investments.

All of this material is included in recent Dow Theory Letters, particularly Letter 723. If you subscribe to Dow Theory Letters with this mailing, I will send you a copy of this crucial Letter 723, the one dealing with the chart shown on this page.

A month ago I sent out a mailer dealing with the "out of control" US debt situation and its meaning to all of us. Every passing week makes me more certain that what I see ahead is going to prove correct. The US is running up staggering deficits of \$75 to \$100 billion a year, and the cost of servicing these debts is compounding. The implications of this debt-hurricane must be understood if you are going to survive the decade ahead. If you doubt that statement, study the very long-term moving average (dotted line) on the chart above. For the first time since the mid-1930's, that moving average is rolling over. Soon it will be heading down.



The response to my mailing a month ago was so gratifying that I am sending out this new follow-up. If you need the kind of advice that I can give, then my urgent suggestion to you is—MOVE! PLEASE fill out the coupon below and get started with your subscription to Dow Theory Letters and special Letter 723. Thank you.

RICHARD RUSSELL

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